

Agenda Item:

# Pension Fund Committee

9

**Dorset County Council**


Date of Meeting	8 September 2014
Officer	Director for Corporate Resources
<b>Subject of Report</b>	<b>Fund Administrator’s Report</b>
Executive Summary	<p>The purpose of this report is to update the Committee on the allocation of the assets and overall performance of the Fund as at the end of the first quarter of the 2014/15 Financial Year to 30th June 2014. The report also provides a commentary on the performance of the fund managers who are not considered elsewhere on the agenda and to address other topical issues for the Fund that do not require a separate report.</p> <p>The Independent Adviser’s report is contained at Appendix 2, and will be presented separately at the meeting.</p> <p>The report shows that overall the Fund returned 2.03% over the quarter, underperforming its benchmark which returned 2.32%. Return seeking assets added 2.23%, whilst the liability matching assets returned 0.09%. For the same period the WM Local Authority average returned 1.9%.</p>
Impact Assessment:	Equalities Impact Assessment: N/a
	Use of Evidence: N/a
	Budget: N/A

	<p>Risk Assessment: The Fund assesses the risks of its investments in detail, and considers them as part of the strategic allocation. In addition, risk analysis is provided alongside the quarterly performance monitoring when assessing and reviewing fund manager performance.</p>
	<p>Other Implications: None</p>
<p>Recommendation</p>	<p>That the Committee :</p> <ul style="list-style-type: none"> <li>i) Review and comment upon the activity and overall performance of the Fund.</li> <li>ii) That no asset allocation changes are made at this time.</li> </ul>
<p>Reason for Recommendation</p>	<p>To ensure that the Fund has the appropriate management arrangements in place and are being monitored, and to keep the asset allocation in line with the strategic benchmark</p>
<p>Appendices</p>	<p>Appendix 1: New Money Forecast Appendix 2: Report of the Independent Adviser Appendix 3: HSBC Manager Performance and Risk analysis for the quarter to 30 June 2014</p>
<p>Background Papers</p>	<p>HSBC Performance Statistics</p>
<p>Report Originator and Contact</p>	<p>Name: Nick Buckland Tel: 01305 224763 Email: n.j.buckland@dorsetcc.gov.uk</p>

## 1. Background

- 1.1 The Dorset County Pension Fund currently receives more money in contributions and investment income than it pays out as pensions and retirement grants. It is anticipated that there will be a surplus of income over expenditure from these cash flows of £71.2M in the 2014-15 financial year. The anticipated cash flows for 2014-15 along with the historic trends are illustrated in Appendix 1.
- 1.2 These “new money” levels are reviewed throughout the year, and Members are alerted if there is any significant variance from what is expected.

## 2. Cash – flow

- 2.1 The table below summarises the main cash flows for the Fund for the three months under review.

	£M	£M
Cash at 1 <sup>st</sup> April 2014		<b>116.3</b>
Less: Property transactions (net)	2.5	
Private Equity drawdowns (net)	0.5	
UK Equity Purchases (net)	0.1	
		<b>3.1</b>
Add: Hedge Fund redemptions	10.6	
Currency Hedge gain	7.0	
Lump sum contributions	24.1	
Net New Money	7.6	
		<b>49.4</b>
Cash at 30 <sup>th</sup> June 2014		<b>162.6</b>

- 2.2 The cash flow above shows the transactions that have taken place up to the end of June 2014, and the largest of these is the up-front payment of deficit contributions from a number of the fund’s larger employers. Employers were required to make the payment to the Fund by the 1 July, and there were 2 employers that chose to pay on 1 July and hence their payments (totalling £24.9 Million) are not shown above.
- 2.3 There have been a number of other significant transactions that have taken place since the 30<sup>th</sup> June. These include the allocations to Insight, rlam and Barings that were agreed by the Committee in June. These totalled £70 Million and were all made in July.
- 2.4 In addition to the £24.9 Million that the Fund received from its Employers in July, there were also receipts of £30.9 Million from IAM, one of the Fund’s fund of hedge fund managers, who is in the process of disinvesting the portfolio.
- 2.5 As a result of these significant transactions, the Fund’s cash balances as at 1 August 2014 were £151.4 Million. Whilst there are a number of transactions projected between now and the end of the financial year, this still leaves the Fund with a significant holding in cash. This has been addressed by a recommendation in the Strategic Asset Allocation paper elsewhere on this agenda, and the position will continue to be monitored.

## 3. Fund Portfolio Distribution

- 3.1 Members will be aware of the changes made to the Fund’s strategy at recent meetings, and therefore, the benchmark against which the asset allocation is currently measured is somewhat a “work in progress”. The table below shows the position as at 30<sup>th</sup> June 2014, and the target allocation shown is subject to the agreement of the recommendation in the Strategic Asset Allocation paper elsewhere on this agenda.

Asset Class	Manager	31 March 2014		30 June 2014	
		£M	%	£M	%
Bonds	(Several)	396.8	19.1%	403.2	18.8%
UK Equities	(Several)	580.7	27.9%	581.3	27.1%
Overseas Equities	(Several)	562.7	27.1%	571.8	26.7%
Property	(CBREi)	187.1	9.0%	196.6	9.2%
Absolute Return Funds	(Several)	90.2	4.3%	79.5	3.7%
Infrastructure	(Several)	-	0.0%	0	0.0%
Private Equity	(Several)	53.2	2.6%	55.7	2.6%
Diversified Growth	(Barings)	92.7	4.5%	94.2	4.4%
Cash	(Internal)	116.3	5.6%	162.6	7.6%
		2,079.8	100%	2,144.9	100%

- 3.2 Given the changes that have taken place since 30 June, as mentioned in Paragraph 2, it is appropriate to update this table to show the position as at 1 August. The table below does this.

Asset Class	Manager	30 June 2014		01 August 2014		Target Allocation	
		£M	%	£M	%	£M	%
Bonds	(Several)	403.2	18.8%	463.1	21.0%	540.6	24.5%
UK Equities	(Several)	581.3	27.1%	581.3	26.3%	606.8	27.5%
Overseas Equities	(Several)	571.8	26.7%	605.0	27.4%	551.7	25.0%
Property	(CBREi)	196.6	9.2%	196.6	8.9%	220.7	10.0%
Absolute Return Funds	(Several)	79.5	3.7%	49.1	2.2%	0.0	0.0%
Infrastructure	(Several)	0	0.0%	-	0.0%	88.3	4.0%
Private Equity	(Several)	55.7	2.6%	55.7	2.5%	88.3	4.0%
Diversified Growth	(Barings)	94.2	4.4%	104.4	4.7%	110.3	5.0%
Cash	(Internal)	162.6	7.6%	151.4	6.9%	0.0	0.0%
		2,144.9	100%	2,206.6	100%	2,206.6	100%

- 3.3 It is clear from the table above that there are a number of areas where the Fund’s allocation is different from the target. It is, however appropriate to consider this as a “work in progress”, moving toward the target allocation over the next 6-9 months. Members will be aware that the allocations to Private Equity and Infrastructure will take a number of months to fully drawdown. Each of these areas is addressed in the Strategic Asset Allocation paper elsewhere on the agenda.

3.4 The area of Diversified Growth is also addressed elsewhere, and members will have considered the recommendation contained within that paper to delay the appointment of a new DGF manager, and allocate the earmarked funds to bonds and equity on a temporary basis. This will also involve amending the strategic benchmark, and this is reflected in the target allocations shown above.

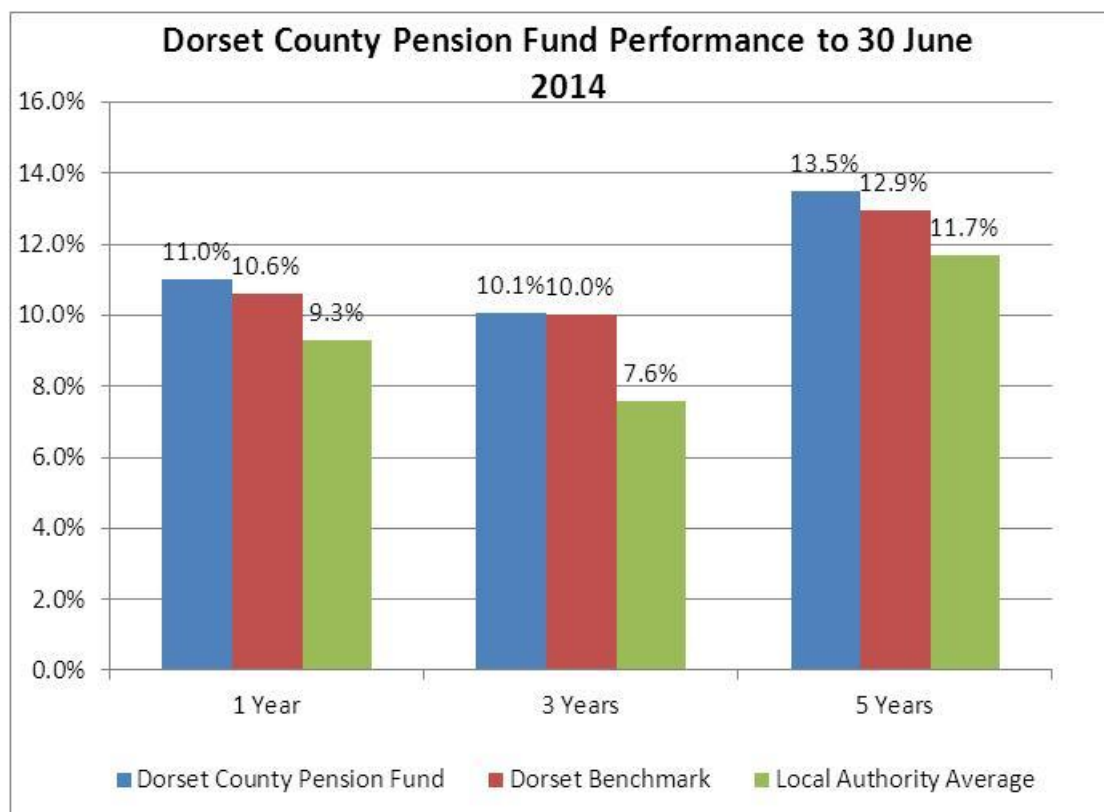
3.5 Given the allocation recommendations made elsewhere, there are, therefore, no additional recommended changes in this report.

#### 4. Overall Fund Performance

4.1 The performance of the Fund during the first quarter shows an overall return of 2.03%, an underperformance of the benchmark of 2.32% by 0.29%. Over the 12 month period the Fund has returned 11.02% against the benchmark of 10.62%, an outperformance of 0.40%.

4.2 The Fund has matched its benchmark over 3 years returning and annualised 10.06% against the benchmark of 10.02%.

4.3 The chart below shows the overall performance for 1, 3 and 5 years against the Fund’s bespoke benchmark, and the Local Authority average performance.



- 4.4 When considering the overall performance it is important to note the split between the “Return seeking assets” and the “Liability matching assets”. Since the implementation of the strategic review in 2012, the Fund has held a proportion of the assets in an Inflation Hedging Strategy, managed by Insight. These assets are not held to add growth, but to match the movements in the Fund’s liabilities. It is therefore important to consider that in normal circumstances, the benchmark movement of these assets is a proxy for the Fund’s liabilities.
- 4.5 This Liability matching strategy, conducted by Insight has returned 19.52% since its inception on 1st July 2012. For the quarter Return seeking assets have returned 2.23% against the benchmark of 2.56%. The Liability Matching assets have returned 0.11% against the benchmark of -0.53%. This strategy is intended to hedge against the impact of increasing pensions liabilities which are linked to, amongst other things; the consumer prices index (CPI). CPI cannot currently be hedged as there is not a sufficiently developed futures market, so the Dorset strategy targets the retail prices index (RPI) swaps market to act as a proxy for CPI which tends to be lower than RPI. The table below shows the overall performance of the Fund, but makes the distinction between the return seeking assets and the liability matching assets.

Asset Category	Manager	3 Months to 30 June 2014		
		Dorset %	Benchmark %	Over/(Under) %
<b>Overall Fund Performance</b>	<b>All</b>	<b>2.03</b>	<b>2.32</b>	<b>-0.29</b>
<b>Total Return Seeking Assets</b>	<b>Various</b>	<b>2.23</b>	<b>2.56</b>	<b>-0.33</b>
UK Equities	(Various)	0.86	2.15	-1.29
Overseas Equities	(Various)	2.17	2.54	-0.37
Bonds	(RLAM)	2.97	2.64	0.33
Property	(CBREi)	5.53	5.06	0.47
Hedge Funds	(Various)	1.34	1.66	-0.32
Private Equity	(Various)	0.46	2.24	-1.78
Diversified Growth	(Barings)	1.64	1.14	0.50
Cash	(Internal)	0.15	0.09	0.06
<b>Total Asset Matching</b>		<b>-6.29</b>	<b>-7.27</b>	<b>0.98</b>
Bonds	(Insight)	0.11	-0.53	0.64

- 4.6 In considering the performance of the Fund as a whole, there are two main areas that explain where the performance is being generated. These are the asset allocation (market contribution) of the Fund and within those allocations the stock selection (selection contribution) choices that have been made. The stock selection element is a measure of the fund managers’ ability to outperform their benchmark. The asset allocation is the effect of decisions to change the weighting of the different asset classes within the Fund.
- 4.7 The HSBC performance report, contained at Appendix 3, gives an attribution analysis of the performance for the quarter on pages 7 and 8. This analysis shows that the market contribution had a positive effect against the benchmark of 17 bps whilst stock selection was negative overall, reducing performance by 44 bps. Return seeking assets had an overall negative contribution of 29bps mainly driven by equities (UK and Overseas) of -45bps, currency hedging added 27 bps. The stock selection contribution was hit by equities, which had a negative contribution of 46bps. In all other areas contributions were broadly negative.

**5. Manager Progress (excluding UK equities)**

Barings Diversified Growth Fund

- 5.1 The Diversified Growth allocation was mandated to Barings on 30 March 2012. Diversified Growth Funds are designed to give fund managers total discretion over how and where they invest which means that the portfolio holds a wide range of investments against a diverse range of asset classes. The Barings fund seeks to achieve out performance against a cash benchmark by focussing on asset allocation decisions. This fund targets equity like returns with about 70% of the equity risk.
- 5.2 The performance of Barings for the three months to 30 June 2014 and since inception is illustrated below.

**Diversified Growth**

	Value at 1 April 2014	Market Value at 30 June 2014	3 months to 30 June 2014		12 months to 30 June 2014	
	(£000’s)	(£000’s)	Performance %	Benchmark %	Performance %	Benchmark %
<b>Barings</b>	92,715	94,240	1.64	1.12	4.57	4.57

5.3 The performance of the Barings fund has been ahead of its benchmark over the three months thanks to its exposure to overseas equities. The Fund manager was disappointed that UK equities did not contribute more to the performance, although this followed a period of outperformance in 2013. Within overseas equities, Japanese equity contributed around 75% of the outperformance.

5.4 Members will be aware of the changes in the senior management at Barings, and the issue that this potentially presents for the Diversified Growth Fund and its investors. The progress under the new management will be carefully monitored over the next 6-12 months.

Active US Equity

5.5 The performance table of Intech is shown below.

**Active US Equity**

	USD \$				GBP £			
	Market Value		Performance %	Benchmark %	Market Value		Performance %	Benchmark %
	01-Apr-14	30-Jun-14			01-Apr-14	30-Jun-14		
<b>Intech</b>	185,004	194,483	5.12	5.23	110,967	113,739	2.50	2.61

5.6 The Intech fund actively manages US equity stocks using disciplined mathematical processes to outperform the benchmark at the same level of risk. During the first quarter the fund made positive returns of 5.12%, although this lagged behind the benchmark of 5.23%. This is in line with expected tolerances and Intech will continue to follow the model that has served it well in the past. Over the past three years, to 30<sup>th</sup> June 2014, the fund has returned an annualised 14.05% which is marginally behind the benchmark (S&P 500) return of 14.16%. Over five years the fund has returned 18.37% per annum against the benchmark of 17.95%.

Emerging Market Equity

5.7 The JP Morgan mandate commenced on 5<sup>th</sup> April 2012. The performance of the investment is shown below.

**Emerging Markets Equity**

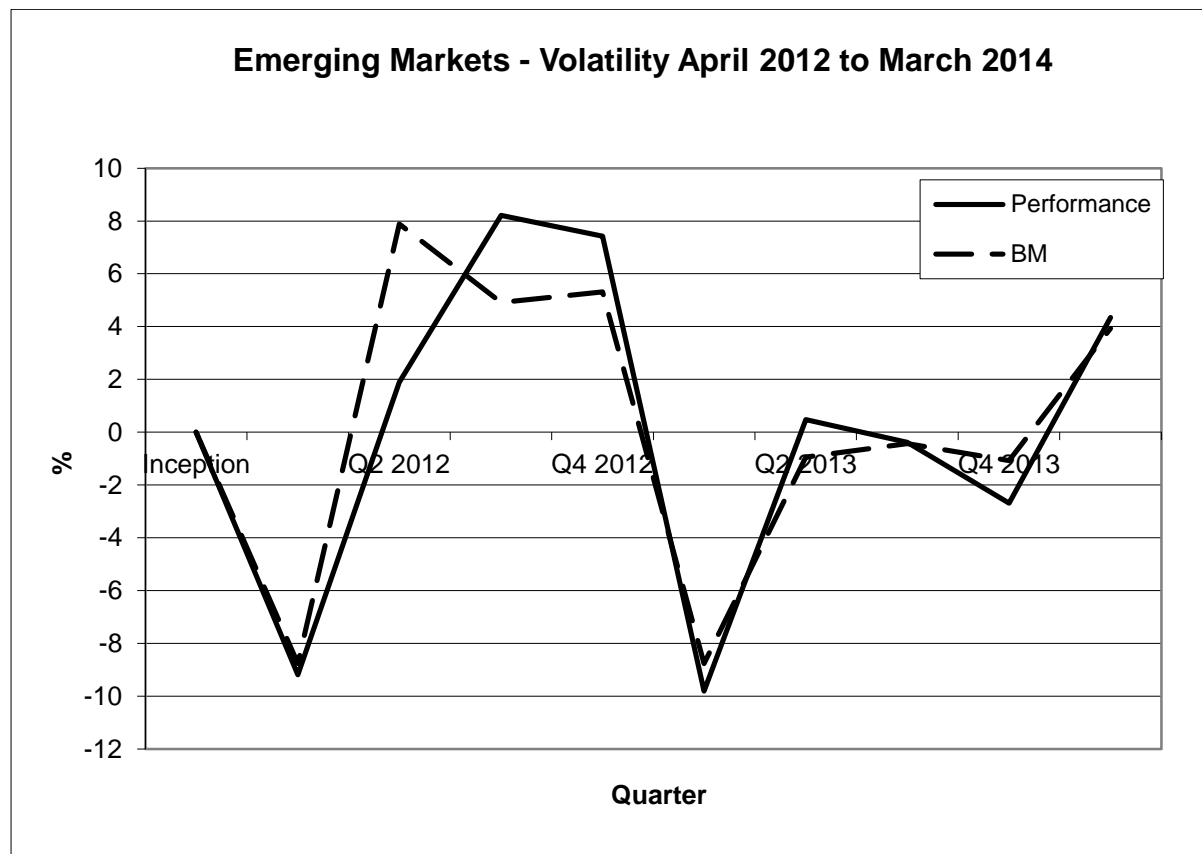
	Value at 1 April 2013	Market Value at 31 March 2014	3 months to 30 June 2014		12 months to 30 June 2014	
	(£000's)	(£000's)	Performance %	Benchmark %	Performance %	Benchmark %
<b>JP Morgan</b>	63,258	66,284	4.34	3.93	1.62	1.40

5.8 Emerging markets had a positive quarter, and the JP Morgan portfolio performed well. The return of 4.34% was ahead of the benchmark by 0.41%. This has helped the longer term performance, and the annual return is now 0.22% ahead of the benchmark at 1.62%. The portfolio continues to hold underweight positions in the markets which are viewed as expensive, such as Malaysia, Poland and Chile, and overweight Russia. JP Morgan view Russia as one of the cheapest markets, and



whilst this may be the case, the recent events in the Ukraine have driven the market lower.

- 5.9 Emerging market equities are seen as the asset class which will offer the most growth over the medium term, albeit with high levels of volatility. The chart below shows the differences in quarterly performance since inception and highlights the volatility of the performance to date alongside the benchmark.



Private Equity

- 5.10 The Pension Fund has committed to investing with Harbour Vest and Standard Life in their Private Equity Fund of Funds. Private Equity is an area that takes several years for commitments to be fully invested, and the table below shows the position as at 30 June 2014.
- 5.11 The table shows the commitment Dorset has made to each fund in Euros and US Dollars, the draw-downs that have taken place to date and the percentage of the total drawdown against Dorset’s commitment. It also shows the funds that have been returned to the Dorset Fund, the valuation as at 30 June 2014 and the total gains or losses, which includes the distribution plus the latest valuation.

**Private Equity Commitments, Drawdowns and Valuations**

Manager	Commitment	Drawn down	% of Commitment	Distribution	Valuation	Gain / (Loss)
	€m	€m		€m	€m	€m
HV Partnership V	12.000	10.920	91%	4.816	9.115	3.011
HV Direct V	3.000	2.880	96%	0.819	2.467	0.406
SL 2006	22.000	18.985	86%	5.830	15.745	2.590
SL 2008	17.000	9.349	55%	0.810	9.379	0.840
	\$m	\$m		\$m	\$m	\$m
HV Venture VIII	15.200	13.604	90%	4.915	14.863	6.174
HV Buyout VIII	22.800	18.468	81%	7.308	17.538	6.378
HV Buyout IX	15.000	2.438	16%	0.072	2.708	0.342
HV Venture IX	10.000	2.700	27%	0.110	3.048	0.458
SL SOF	16.500	0.000	0%	0.000	0.000	0.000

- 5.12 Private Equity is a long term investment and as such the performance should be reviewed over the longer term. The benchmark used for this fund is the FTSE All Share index. The table below shows the performance over 3 and 5 years against the benchmark.

**Private Equity Overall Performance**

Manager	3 Years to 30 June 2014		5 Years to 30 June 2014	
	Dorset %	Benchmark %	Dorset %	Benchmark %
HarbourVest	10.97	8.92	15.02	14.49
Standard Life	8.63	8.92	11.95	14.49

**Hedge Fund (Absolute Returns) Managers**

- 5.13 The Pension Fund has active investments with two Fund of Hedge Fund managers; International Asset Management (IAM), and Gottex. There are also investments in delayed redemption funds with the previous manager, Pioneer.

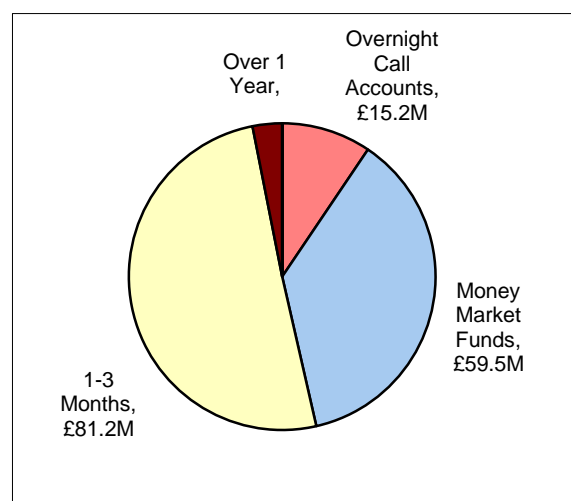
Manager	Value at 1 April 2014	Market Value 30 June 2014	3 Month Performance %	3 Month Benchmark %	3 Year Performance %	3 Year Benchmark %
Gottex (£000's)	32,341	32,705	1.12	1.38	3.07	5.71
Pioneer (£000's)	1,800	1,496	2.41	1.63	7.24	6.77
IAM (£000's)	56,101	45,259	1.48	1.80	3.74	7.40

- 5.14 Members will be aware that the Fund’s investments in fund of hedge funds are in the process of being redeemed, and this is likely to be concluded by the end of September. This is therefore the last time that performance of this asset class will be reported in this way.

## **6. Treasury Management**

- 6.1 The Fund generates cash flows throughout the year which need to be managed. The Fund therefore holds a proportion of cash that is invested in call accounts, money market funds and fixed term deposits. A breakdown of the balances held internally as at 30 June 2014 is shown in the table below. Additional cash balances are also held tactically by Pictet within their overseas equity portfolio, and there is a small amount of cash held with the custodian bank account at HSBC and in a Property rent collection account where a float is required to be held for working capital purposes.
- 6.2 Since the credit crunch, there has been a significant reduction in the number of countries and financial institutions that are deemed safe for investments. The Council’s treasury management advisers have recently advised that cash balances can be invested for more than 3 months in the big four UK banking groups. The majority of cash continues to be lent for less than 3 months in UK institutions to ensure that the money is both secure and liquid, and so it is available for distribution.
- 6.3 In terms of performance, the weighted average yield continues to reduce as, higher return investments mature and have to be replaced with lower rate ones. Internally managed cash returned 0.15% over the three months, which is ahead of the benchmark, as measured by the 7 day LIBID at 0.09%. Over the twelve months the Fund has achieved 0.76% against the benchmark of 0.37%. These low market rates have broadly been caused by the funding for lending scheme and Bank of England restrictions on how banks have to treat liquid deposits.

<b>Lender/Borrower</b>	<b>Amount £'000</b>	<b>Rate %</b>
<b><u>Fixed Term Deposits</u></b>		
Lloyds Banking Group	5,000	1.00
Lloyds Banking Group	10,000	0.89
Lloyds Banking Group	5,000	0.98
Nationwide Building Society	10,000	0.56
Lloyds Banking Group	5,000	0.66
Barclays Bank Plc	15,000	0.51
Nationwide Building Society	5,000	0.47
Oversea- Chinese Banking Corp	5,000	0.45
Nordea Bank	10,000	0.53
Credit Suisse AG	15,000	0.53
Dorset Police and Crime Commissioner	1,200	0.38
<b>Total Loans</b>	<b>86,200</b>	
<b><u>Call Accounts</u></b>		
National Westminster Bank	215	0.25
Svenska Handelsbanken	15,000	0.50
<b>Total Call Accounts</b>	<b>15,215</b>	
<b><u>Money Market Funds</u></b>		
Ignis MMF	15,000	0.45
Federated Prime Rate MMF	15,000	0.41
BlackRock MMF	15,000	0.38
Goldman Sachs MMF	14,500	0.38
<b>Total Money Market Funds</b>	<b>59,500</b>	
<b>Total Cash</b>	<b>160,915</b>	<b>0.49</b>



## 9. Reform of the LGPS

- 9.1 At the meeting of the Committee in June 2014 the two latest government consultations were discussed. The first consultation, titled “LGPS: Opportunities for collaboration, cost savings and efficiencies”, focussed on the potential for LGPS funds to have greater collaboration in the investment process. It included proposals for the greater use of passive management, and greater use of Collaborative Investment Vehicles (CIVs).
- 9.2 There has been a good deal of debate locally and nationally over the points raised in this consultation, and there has also been some questions raised over the level of the potential savings. At the June meeting of the Committee members raised a number of points that it was felt needed to be included in Dorset’s response to the consultation. These points and others were included in the response that was made

to the Department for Communities and Local Government by the deadline of 11 July 2014. Members were sent a copy of the final response by email.

- 9.3 The second consultation paper that was discussed at the last meeting was the draft regulations on governance. These regulations focus on the requirements relating to the governance arrangements of LGPS funds, due to the Public Sector Pensions Act.
- 9.4 The Public Sector Pensions Act requires all public sector schemes to create and maintain National and Local Boards to oversee the Fund. The draft regulations proposed a framework for the operation of Local Boards, but as yet, answer very few of the questions that are needed to operate the Boards effectively. It is understood that the Shadow National Board is working on guidelines for LGPS funds to implement the regulations, and this should be available later in 2014.
- 9.5 Assuming the draft regulations do not change significantly as a result of the consultation, local Authorities will be required to setup a Local Pensions Board by 1 April 2015. As mentioned previously how the Boards will operate, and their makeup is still a bit vague, however it is important that Dorset is prepared ahead of the formal guidelines, an ensures that a Board is in place. Therefore, a report will be made to this Committee at its next meeting in November which will recommend the creation of such a Board to the County Council. This recommendation will then have to proceed to the Council’s Standards Committee, and then be presented to the Full Council for agreement in February 2015.

## **10. Asset Allocation**

- 10.1 As mentioned above asset allocation changes have been recommended elsewhere on this agenda and therefore no further changes are recommended.

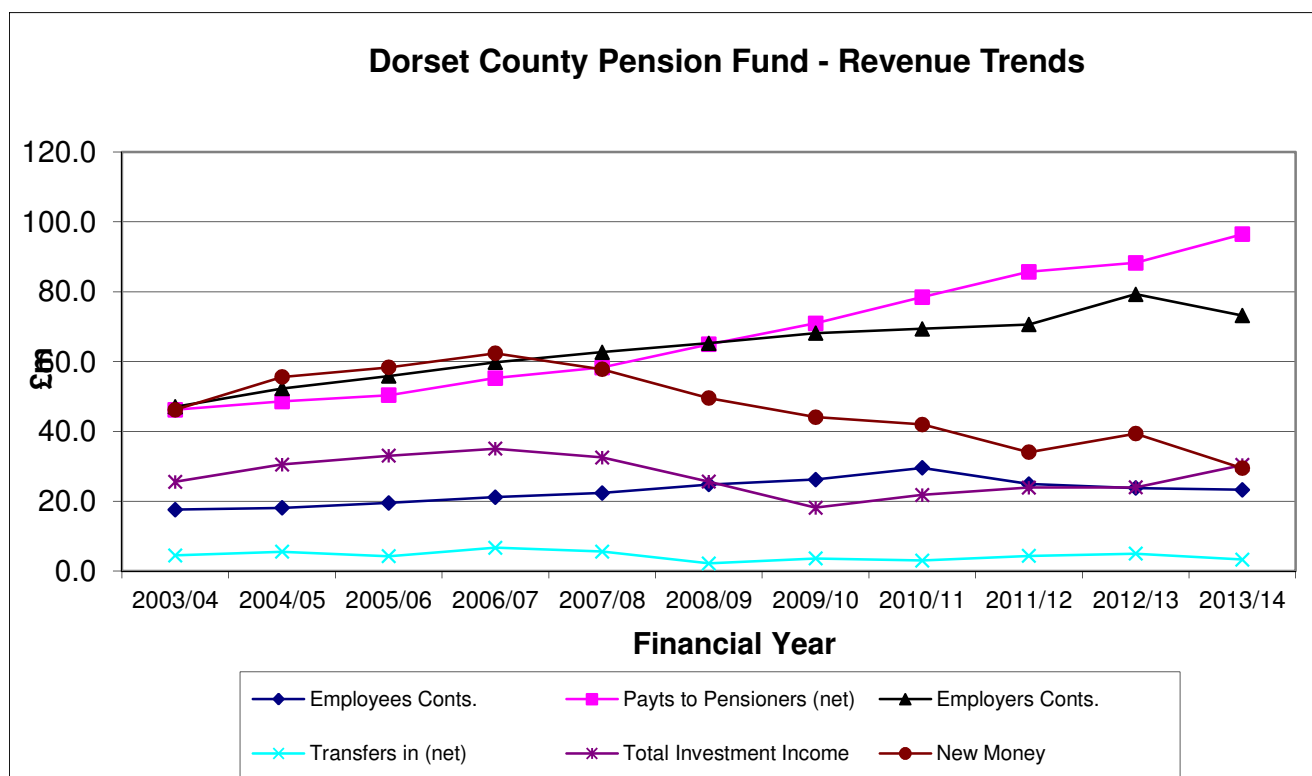
**Paul Kent**  
**Pension Fund Administrator**  
August 2014

## Appendix 1

### BUDGET MONITORING

	Actual 2012/2013	Actual 2013/14	Estimate 2014/15
	£'000	£'000	£'000
<b>INCOME:</b>			
Employers' Contributions	81,579	78,474	114,400
Employees' Contributions	24,097	25,412	25,900
Transfer Values (net)	3,627	3,961	3,700
Investment Income	29,521	31,649	32,600
<b>TOTAL INCOME:</b>	<b>138,824</b>	<b>139,496</b>	<b>176,600</b>
<b>EXPENDITURE:</b>			
Net Management Expenses	4,202	4,278	4,300
Payments to Pensioners (net)	90,521	93,803	101,100
<b>TOTAL EXPENDITURE:</b>	<b>94,723</b>	<b>98,081</b>	<b>105,400</b>
<b>NET NEW MONEY FOR THE YEAR</b>	<b>44,101</b>	<b>41,415</b>	<b>71,200</b>

### REVENUE TRENDS & FORECASTS



**REPORT OF THE INVESTMENT ADVISER  
PREPARED FOR**

**Dorset County Pension Fund**

**Pension Fund Committee**

**On September 8th 2014**

**Investment Outlook**

**Alan Saunders**

**AllenbridgeEpic Investment Advisers Limited (AllenbridgeEpic)**

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**Dorset County Council Pension Fund**  
**September 2014**  
**Report of the Investment Adviser**

**Investment Outlook**

After moving sideways in the first quarter of the year, equity markets advanced modestly in Q2 with emerging markets staging something of a recovery. Gilt prices remained steady despite growing evidence of UK economic recovery and UK property continued its strong advance. After 2013's bull run, this has been a year of consolidation so far for equities with volatility remaining low and sentiment broadly constructive, based on the premise of monetary policy remaining loose. Geopolitical concerns continue to be ignored.

We are coming towards the end of US tapering while the Bank of England, having given up on forward guidance, seems more inclined to contemplate raising interest rates. Conventional wisdom suggests that markets will sell off when this happens but in reality the economy should be able to withstand a moderate rise in base rates. As we have said before, equities look fairly fully priced without being at peak valuation levels. Provided earnings support is forthcoming, markets could trend higher but the spectre of monetary tightening next year constrains upside.

**Economy**

The US economy has bounced back from the weather affected Q1 with growth of 4% after a 2% decline in output. Latest employment numbers have been very positive with the economy moving back slowly towards trend growth of some 3%. The end of tapering in the autumn is unlikely to be followed immediately by Fed tightening with consumer spending and housing looking far from robust.

UK recovery is of course more pronounced at present and economic activity has at last exceeded the peak of 2008. It has of course taken a lot longer than in the US as our incipient recovery got knocked on the head by the Euro crisis. The strength of the employment market has amazed all forecasters but wages growth remains weak. That, combined with the strength of sterling, continues to keep inflation subdued around the BoE's target. Governor Carney continues to throw off mixed signals about tightening policy but markets have brought forward the date to next year now.

The expected further relaxation of policy in Europe took place with a modest cut in interest rates and extended short term lending facilities but still stopping short of QE. Economic activity continues to stagnate and inflation remains perilously close to becoming deflation. The European approach has been muted compared to Japan with a similar challenge. As expected, some European banks are struggling to meet stress tests on capital adequacy and a Portuguese bank has now had to be rescued after an Italian bank earlier in the year. These challenges to market confidence have not been too severe in their consequences but the motors to growth in Europe remain weak.

Elsewhere, Japan appears to be picking up after the sales tax increase but growth remains dampened at below 2%. In emerging markets, there is growing confidence that China will succeed in reducing the excesses of the economy without threatening growth and latest figures support 7% growth. Sentiment towards emerging markets is picking up and currencies have recovered much of last year's losses.



In terms of currencies, sterling remains strong. Against the dollar it is up 3% this year and 11% over the last twelve months. Against the euro, it is up 4% and 7% respectively. Markets are anticipating the UK leading the rise in interest rates but sterling looks expensive now.

It is worth mentioning that not everyone buys into the mantra of keeping monetary policy looser for longer. The Bank of International Settlements in Basle, the so-called central bankers' bank- argues strongly that policy is far too loose, that inflation is just around the corner and central banks should start raising rates now!!

## Markets

The gilt market continues to surprise on the positive side. The All Stocks Index shows a return of over 3% for the first half of the year with the over 15 year index producing almost 6%. Nominal gilts have outperformed index linked as inflationary expectations have fallen a little. Corporate bonds which have a lower duration than gilts have outperformed slightly as credit spreads have narrowed in further. High yield bonds have done better still as investors continue to chase yield and much the same is true of emerging market bonds. As I suggested last time, credit markets look as stretched as equities in terms of valuation. Spreads are pretty well back to pre-crisis levels as far as investment grade bonds are concerned though default risk remains low.

Global equities have produced a similar return of around 3% in the first half of the year, mostly arising in Q2. There is little to choose between the UK, US and Europe when allowing for currency as sterling strength has reduced returns from overseas equities. Japan is still down on the year to date but staged a recovery in Q2 while emerging markets are slightly ahead in a close field though China and Russia are still negative for the year. India, in particular, Brazil and South Africa are all positive.

Most commentators assume the bull trend for equities is still intact though some value-orientated investors still await a major correction on valuation grounds. On conventional valuations measures such as forward price earnings or price to book, developed markets look fairly valued to slightly over-priced while emerging markets look good value. Markets may mark time for a longer period of time- as the UK market has done this year- until confirmation of global profits recovery comes through. The US in contrast is at a mature stage in its profits cycle as margins have been rebuilt in recent years but investors are waiting for some signs of top line sales growth as the recovery kicks in. Elsewhere, it is a question of waiting for both sales growth and margin improvement. Above all, markets are assuming this recovery will come before monetary policy tightens significantly.

## Property

UK commercial property continues to storm ahead with a reported 10% total return for the first half. Recovery has been across the board with a pronounced narrowing of the gap between prime and secondary yields so that very good returns have been made in areas like industrial. Central London continues to hold up but outside the south east, offices show continuing high vacancy levels in certain areas. As a sign of renewed investor confidence, quoted property companies like REITs have moved now to a premium. The positive return profile is expected to continue well into next year with rental growth supplementing yield compression

## Alternatives

Alternatives are held as diversifying assets, mainly against equities and many are benchmarked against cash. They can be multi-asset structures engaging in tactical asset allocation decisions over markets as well as sometimes doing relative value trades like hedge funds. Some specialise purely in credit. Other longer duration asset classes like private equity and infrastructure generate a so-called illiquidity premium and may have an equity benchmark like private equity or inflation benchmark like infrastructure. Diversified Growth funds cover the former category with a cash plus benchmark and the scheme is now adding infrastructure to private equity to fill out the long duration category.

## Asset Allocation

Bonds and equities continue surprisingly to generate similar returns in the year to date in contrast to last year when equities outperformed strongly. We do not engage in tactical changes across the major asset classes other than occasional rebalancing when assets classes stray outside agreed ranges. Instead we leave that to our diversified Growth manager to add value at the margin. A comment on currency hedging which can sometimes seem unnecessary when sterling is weak. The recent period of pronounced sterling strength validates the hedging policy.

I went in some detail in the last report on the strategic reasons behind the current allocation and proposed changes and have little new to say on the subject. Unlike corporate pension schemes which are derisking over time by selling down equities and building up hedges against liability risk, local authority schemes are not under the same pressure. We therefore maintain a fairly high equity exposure though less than the LA average. It will be interesting to see whether this becomes an issue as and when LA schemes come under the scrutiny of the Pension Regulator.

Alan Saunders Senior Adviser

Allenbridge Epic Investment Advisers



**Dorset County Pension Fund Total**

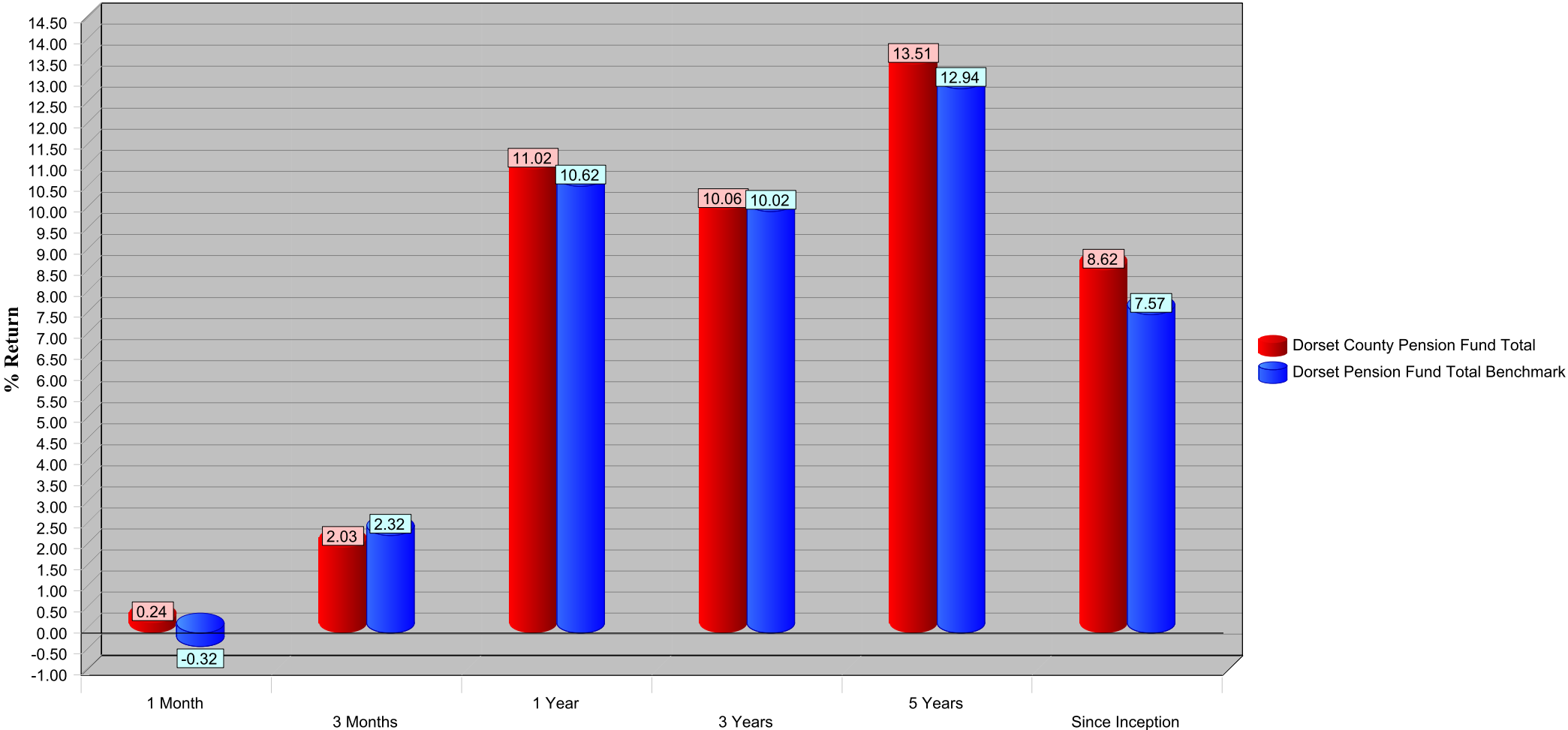
**01 Apr 2014 - 30 Jun 2014**

## Manager Summary

Portfolio	Initial Market Value	Initial Market Value %	Net Investment	Capital Gain / Loss	Final Market Value	Final Market Value %	Income	Portfolio Return %	Benchmark Return %
<b>Dorset County Pension Fund Total</b>	<b>2,080,695,680</b>	<b>100.00</b>	<b>28,235,275</b>	<b>32,762,961</b>	<b>2,141,693,916</b>	<b>100.00</b>	<b>9,463,068</b>	<b>2.03</b>	<b>2.32</b>
Dorset - AXA Framlington UK Equity	102,820,736	4.94		-2,056,648	100,764,088	4.70		-2.00	2.24
Dorset - Barings Asset Management	92,714,625	4.46		1,525,145	94,239,770	4.40		1.64	1.12
Dorset - CBRE Property	187,103,558	8.99	2,508,150	6,962,717	196,574,424	9.18	3,477,204	5.53	5.06
Dorset - Currency Hedging	0	0.00	-5,831,890	5,831,890	0	0.00		201.10	
Dorset - Gottex Hedge Fund	32,340,874	1.55		363,773	32,704,647	1.53		1.12	1.38
Dorset - HarbourVest Private Equity	32,461,796	1.56	-168,140	324,201	32,617,857	1.52		1.01	2.24
Dorset - IAM Hedge Fund	56,101,381	2.70	-11,473,059	631,186	45,259,508	2.11		1.48	1.80
Dorset - Insight Fund	199,426,885	9.58		180,508	199,607,392	9.32		0.09	0.09
Dorset - Internally Managed Cash	117,877,610	5.67	43,752,065	-1	161,629,673	7.55	188,734	0.15	0.09
Dorset - Internally Managed UK Equity	365,643,358	17.57	89,513	4,629,087	370,361,958	17.29	4,289,655	2.44	2.30
Dorset - JP Morgan	63,527,522	3.05		2,756,448	66,283,971	3.09		4.34	3.93
Dorset - Janus Intech US Equity Fund	110,966,854	5.33		2,772,639	113,739,492	5.31		2.50	2.61
Dorset - Pictet Global ex UK Equity	387,613,062	18.63	-829,857	4,998,345	391,781,550	18.29	1,356,879	1.64	2.23
Dorset - Pioneer Hedge Fund	1,800,440	0.09	-336,422	31,848	1,495,866	0.07		2.41	1.63
Dorset - Royal London Bonds	197,328,985	9.48	145,684	5,702,867	203,177,536	9.49	150,595	2.97	2.64
Dorset - Schroders UK Equity	33,322,350	1.60	-41,856	-117,377	33,163,117	1.55		-0.35	-1.61
Dorset - Standard Life Private Equity	20,770,265	1.00	559,418	-81,457	21,248,226	0.99		-0.36	2.24
Dorset - Standard Life UK Equity	78,875,379	3.79	-138,331	-1,692,208	77,044,841	3.60		-2.15	2.24

All periods > 1 year have been annualised.

Long Term Performance, Total Fund



All periods > 1 year have been annualised.

## Gain/Loss Analysis

Category	Initial Market Value	Net Investment	Final Market Value	Capital Gain/Loss	Income	% Return
<b>TOTAL ASSETS</b>	<b>2,080,695,680</b>	<b>28,235,275</b>	<b>2,141,693,916</b>	<b>32,762,961</b>	<b>9,463,068</b>	<b>2.03</b>
<b>Total Return Seeking Assets</b>	<b>1,881,268,795</b>	<b>28,235,275</b>	<b>1,942,086,524</b>	<b>32,582,453</b>	<b>9,463,068</b>	<b>2.23</b>
Total Assets ex Hedging	1,881,268,795	34,067,166	1,942,086,524	26,750,563	9,463,068	1.93
Total Equities	1,106,626,076	155,852	1,117,568,798	10,786,870	5,611,660	1.48
UK	580,661,824	-90,673	581,334,004	762,854	4,289,655	0.86
Dorset UK Internally Managed	365,643,358	89,513	370,361,958	4,629,087	4,289,655	2.44
AXA Framlington UK Equity	102,820,736		100,764,088	-2,056,648		-2.00
Standard Life UK Equity Select Fund	78,875,379	-138,331	77,044,841	-1,692,208		-2.15
Schroders UK Small Cap Equity	33,322,350	-41,856	33,163,117	-117,377		-0.35
Overseas Equities	525,964,252	246,525	536,234,794	10,024,016	1,322,005	2.17
North America	308,183,699	-878,312	314,427,352	7,121,965	275,625	2.41
Pictet North America	197,216,845	-878,312	200,687,859	4,349,326	275,625	2.36
Janus Intech US Equity	110,966,854		113,739,492	2,772,639		2.50
Europe ex UK	94,783,778	2,103,142	95,343,108	-1,543,813	1,011,048	-0.54
Pictet Europe ex UK	94,783,778	2,103,142	95,343,108	-1,543,813	1,011,048	-0.54
Japan	41,593,381	4,752,906	48,517,808	2,171,521	8,401	4.74
Pictet Japan Equity	41,593,381	4,752,906	48,517,808	2,171,521	8,401	4.74
Pacific ex Japan	17,875,872	-5,731,212	11,662,556	-482,105	26,930	-2.10
Pictet Pacific ex Japan	17,875,872	-5,731,212	11,662,556	-482,105	26,930	-2.10
Emerging Markets	63,527,522		66,283,971	2,756,448		4.34
JP Morgan Global Emerging Markets	63,527,522		66,283,971	2,756,448		4.34
Total Bonds	197,328,985	145,684	203,177,536	5,702,867	150,595	2.97
Royal London Bonds	197,328,985	145,684	203,177,536	5,702,867	150,595	2.97
Total Property	187,103,558	2,508,150	196,574,424	6,962,717	3,477,204	5.53
ING Property	187,103,558	2,508,150	196,574,424	6,962,717	3,477,204	5.53
Total Cash	154,020,795	42,675,683	197,199,892	503,414	223,609	0.47
Total Hedge Funds	90,242,696	-11,809,481	79,460,022	1,026,807		1.34
Gottex Hedge Fund	32,340,874		32,704,647	363,773		1.12
Pioneer Hedge Fund	1,800,440	-336,422	1,495,866	31,848		2.41
IAM (Hedged)	56,101,381	-11,473,059	45,259,508	631,186		1.48

Gain/Loss Analysis

Category	Initial Market Value	Net Investment	Final Market Value	Capital Gain/Loss	Income	% Return
IAM Hedge Fund	56,101,381	-10,255,761	45,259,508	-586,112		-1.15
Currency Hedging (IAM)		-1,217,298		1,217,298		-200.00
Private Equity	53,232,061	391,278	53,866,082	242,744		0.46
HarbourVest	32,461,796	-168,140	32,617,857	324,201		1.01
Standard Life Private Equity	20,770,265	559,418	21,248,226	-81,457		-0.36
Diversified Growth Fund	92,714,625		94,239,770	1,525,145		1.64
Baring Dynamic Asset Allocation Fund	92,714,625		94,239,770	1,525,145		1.64
Total Currency Hedging	0	-5,831,890	0	5,831,890		201.10
<b>Total Matching Assets</b>	<b>199,426,885</b>		<b>199,607,392</b>	<b>180,508</b>		<b>0.09</b>
Insight Liability Fund	199,426,885		199,607,392	180,508		0.09

All periods > 1 year have been annualised.

## Asset Allocation

Category	Initial Market %		Final Market %		Local Currency % Return		Base Currency % Return	
	Portfolio	Benchmark	Portfolio	Benchmark	Portfolio	Benchmark	Portfolio	Benchmark
<b>TOTAL ASSETS</b>	<b>100.00</b>	<b>100.00</b>	<b>100.00</b>	<b>100.00</b>	<b>2.62</b>	<b>2.90</b>	<b>2.03</b>	<b>2.32</b>
<b>Total Return Seeking Assets</b>	<b>90.42</b>	<b>90.00</b>	<b>90.68</b>	<b>90.00</b>	<b>2.89</b>	<b>3.22</b>	<b>2.23</b>	<b>2.56</b>
Total Assets ex Hedging	90.42	90.00	90.68	90.00	2.58	3.22	1.93	2.56
Total Equities	53.19	55.00	52.18	55.00	2.51	3.42	1.48	2.35
UK	27.91	29.00	27.14	29.00	0.86	2.15	0.86	2.15
Dorset UK Internally Managed	17.57	20.00	17.29	20.00	2.44	2.30	2.44	2.30
AXA Framlington UK Equity	4.94	4.00	4.70	4.00	-2.00	2.24	-2.00	2.24
Standard Life UK Equity Select Fund	3.79	4.00	3.60	4.00	-2.15	2.24	-2.15	2.24
Schroders UK Small Cap Equity	1.60	1.00	1.55	1.00	-0.35	-1.61	-0.35	-1.61
Overseas Equities	25.28	26.00	25.04	26.00	4.34	4.82	2.17	2.54
North America	14.81	13.65	14.68	13.65	4.86	5.27	2.41	2.82
Pictet North America	9.48	9.65	9.37	9.65	4.71	5.28	2.36	2.91
Janus Intech US Equity	5.33	4.00	5.31	4.00	5.12	5.23	2.50	2.61
Europe ex UK	4.56	5.35	4.45	5.35	2.71	3.40	-0.54	0.00
Pictet Europe ex UK	4.56	5.35	4.45	5.35	2.71	3.40	-0.54	0.00
Japan	2.00	2.10	2.27	2.10	5.69	4.95	4.74	4.03
Pictet Japan Equity	2.00	2.10	2.27	2.10	5.69	4.95	4.74	4.03
Pacific ex Japan	0.86	1.10	0.54	1.10	-0.11	3.99	-2.10	3.03
Pictet Pacific ex Japan	0.86	1.10	0.54	1.10	-0.11	3.99	-2.10	3.03
Emerging Markets	3.05	3.80	3.09	3.80	4.34	5.25	4.34	4.04
JP Morgan Global Emerging Markets	3.05	3.80	3.09	3.80	4.34	5.25	4.34	4.04
Total Bonds	9.48	10.00	9.49	10.00	2.97	2.64	2.97	2.64
Royal London Bonds	9.48	10.00	9.49	10.00	2.97	2.64	2.97	2.64
Total Property	8.99	10.00	9.18	10.00	5.53	5.06	5.53	5.06
ING Property	8.99	10.00	9.18	10.00	5.53	5.06	5.53	5.06
Total Cash	7.40		9.21		0.47		0.47	
Total Hedge Funds	4.34	6.00	3.71	6.00	1.39	1.66	1.34	1.66
Gottex Hedge Fund	1.55	2.00	1.53	2.00	1.12	1.38	1.12	1.38
Pioneer Hedge Fund	0.09		0.07		5.03	1.63	2.41	1.63
IAM (Hedged)	2.70	4.00	2.11	4.00	1.48	1.80	1.48	1.80



Asset Allocation

Category	Initial Market %		Final Market %		Local Currency % Return		Base Currency % Return	
	Portfolio	Benchmark	Portfolio	Benchmark	Portfolio	Benchmark	Portfolio	Benchmark
IAM Hedge Fund	2.70	4.00	2.11	4.00	-1.15	1.80	-1.15	1.80
Currency Hedging (IAM)							-200.00	
Private Equity	2.56	4.00	2.52	4.00	2.15	2.24	0.46	2.24
HarbourVest	1.56	2.00	1.52	2.00	3.80	2.24	1.01	2.24
Standard Life Private Equity	1.00	2.00	0.99	2.00	-0.36	2.24	-0.36	2.24
Diversified Growth Fund	4.46	5.00	4.40	5.00	1.64	1.12	1.64	1.12
Baring Dynamic Asset Allocation Fund	4.46	5.00	4.40	5.00	1.64	1.12	1.64	1.12
Total Currency Hedging	0.00		0.00		201.10		201.10	
<b>Total Matching Assets</b>	<b>9.58</b>	<b>10.00</b>	<b>9.32</b>	<b>10.00</b>	<b>0.09</b>	<b>0.09</b>	<b>0.09</b>	<b>0.09</b>
Insight Liability Fund	9.58	10.00	9.32	10.00	0.09	0.09	0.09	0.09

All periods > 1 year have been annualised.

## Relative Attribution

Category	Currency Contribution	Market Contribution	Selection Contribution	Total Contribution
<b>TOTAL ASSETS</b>	<b>-0.00</b>	<b>0.17</b>	<b>-0.44</b>	<b>-0.28</b>
<b>Total Return Seeking Assets</b>	<b>-0.00</b>	<b>0.16</b>	<b>-0.44</b>	<b>-0.29</b>
Total Assets ex Hedging	-0.00	-0.12	-0.44	-0.56
Total Equities	0.03	-0.01	-0.46	-0.45
UK	-0.01	-0.02	-0.33	-0.35
Dorset UK Internally Managed	-0.01	0.01	0.02	0.02
AXA Framlington UK Equity	0.00	-0.00	-0.21	-0.21
Standard Life UK Equity Select Fund	-0.00	0.00	-0.16	-0.16
Schroders UK Small Cap Equity	0.00	-0.03	0.02	-0.00
Overseas Equities	0.03	0.01	-0.14	-0.10
North America	-0.02	0.02	-0.06	-0.06
Pictet North America	0.00	-0.01	-0.05	-0.05
Janus Intech US Equity	-0.03	0.03	-0.01	-0.00
Europe ex UK	0.03	-0.00	-0.03	-0.01
Pictet Europe ex UK	0.03	-0.00	-0.03	-0.01
Japan	-0.00	0.01	0.01	0.02
Pictet Japan Equity	-0.00	0.01	0.01	0.02
Pacific ex Japan	-0.00	-0.01	-0.04	-0.05
Pictet Pacific ex Japan	-0.00	-0.01	-0.04	-0.05
Emerging Markets	0.04	-0.02	-0.03	-0.00
JP Morgan Global Emerging Markets	0.04	-0.02	-0.03	-0.00
Total Bonds	-0.00	0.00	0.03	0.03
Royal London Bonds	-0.00	0.00	0.03	0.03
Total Property	-0.01	-0.02	0.05	0.02
ING Property	-0.01	-0.02	0.05	0.02
Total Cash	0.04	-0.18		-0.13
Total Hedge Funds	-0.01	0.08	-0.08	-0.01
Gottex Hedge Fund	-0.00	0.01	-0.00	0.00
Pioneer Hedge Fund	-0.00	0.00		-0.00

Relative Attribution

Category	Currency Contribution	Market Contribution	Selection Contribution	Total Contribution
IAM (Hedged)	-0.01	0.07	-0.07	-0.01
IAM Hedge Fund	-0.01	0.01	-0.07	-0.07
Currency Hedging (IAM)	0.00	0.06		0.06
Private Equity	-0.05	0.01	-0.00	-0.04
HarbourVest	-0.04	0.00	0.02	-0.02
Standard Life Private Equity	-0.01	0.01	-0.03	-0.02
Diversified Growth Fund	-0.00	0.01	0.02	0.03
Baring Dynamic Asset Allocation Fund	-0.00	0.01	0.02	0.03
Total Currency Hedging	0.00	0.27		0.27
<b>Total Matching Assets</b>	<b>-0.00</b>	<b>0.01</b>	<b>0.00</b>	<b>0.01</b>
Insight Liability Fund	-0.00	0.01	0.00	0.01

All periods > 1 year have been annualised.

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This portfolio has not been independently validated by IPD.